No. 92-854

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

Petitioner,

vs.

FIRST INTERSTATE BANK OF DENVER, N.A. and JACK K. NABER,

Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Tenth Circuit

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF SECURITIES AND COMMERCIAL LAW ATTORNEYS IN SUPPORT OF RESPONDENTS

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QUESTIONS PRESENTED

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

2. Whether recklessness satisfies the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act.

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I. INTEREST OF AMICUS CURIAE

The National Association of Securities and Commercial Law Attorneys ("NASCAT") is an association of law firms and attorneys located throughout the United States. The association advocates principled interpretation and application of the federal securities laws to protect investors from manipulative and deceptive practices and to ensure that United States securities markets operate freely and efficiently. NASCAT's members frequently represent victims of securities fraud in cases prosecuted under the federal securities laws. NASCAT and its members accordingly have an interest in the effective private enforcement of the federal securities laws.

NASCAT strongly opposes petitioner's argument that this Court should overrule nearly half a century of precedent under § 10(b) of the Securities Exchange Act (the "Exchange Act") by holding that the long-recognized liability of aiders and abettors who substantially assist the perpetration of securities fraud should now be abolished without congressional action. NASCAT also strongly opposes petitioner's arguments that this Court should overrule decades of precedent holding reckless indifference suffices to establish the element of scienter in cases such as this.

II. INTRODUCTION

Petitioner and amici in their support have briefed this case as if the recognition of a damage claim for aiding and abetting a violation of § 10(b) was new, radical, and inconsistent with other closely related aspects of the securities laws. That is flatly incorrect.

Simply put, aiding and abetting securities fraud is a deceptive practice, and any deceptive or manipulative practice designed to mislead investors is actionable under § 10(b) and Rule 10b-5. *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Aiding and abetting a violation of § 10(b) exposes one to criminal liabilities and SEC enforcement

actions. No rational theory suggests that the same conduct does not expose the same parties to damage liability under the same statute. *See* pp. 3-17, *infra*. Not surprisingly, aiding and abetting a violation of § 10(b) has long been recognized to be civilly actionable for damages; indeed, its recognition was virtually simultaneous with the recognition of a private right of action. *See* pp. 10-17, *infra*.

If the language and purpose of the statute did not itself prohibit aiding and abetting securities fraud, still the general rule would apply that one who aids and abets violation of a statute is equally liable for violating the statute. *See* pp. 3-9, *infra*. Congress has, indeed, provided by express legislation that anyone who aids and abets the violation of a statute such as § 10(b) is a principal violator of the statute. *See* 18 U.S.C. § 2(a).

Because the implied cause of action always has encompassed liability for aiding and abetting securities fraud, holding aiders and abettors liable under § 10(b) does not require extension of the existing implied cause of action for violation of the statute – a cause of action that has been recognized for decades *and approved by Congress*. The question presented in this case is not whether the Court should create a new implied cause of action for aiding and abetting a violation of § 10(b), but whether this Court should overturn decades of settled precedent – acquiesced in and affirmatively approved by Congress – to hold that those who violate § 10(b) by aiding and abetting a securities fraud shall now be immune to civil damage liability to their victims, even though they can be jailed, enjoined, and ordered to disgorge unlawful profits to the SEC.

The second question presented is whether this Court should hold that those who recklessly aid and abet securities fraud should be immune to liability if they were not subject to some pre-existing duty to disclose or act. Petitioners ignore the fact that *everyone* has a duty not to perpetrate or to assist in fraud. *See* pp. 21-22, 28-30, *infra*.

The Courts of Appeal have uniformly held that recklessness satisfies the scienter requirement for a primary violation of § 10(b), and unless this Court intends to overturn that solid line of authority, the question presented is whether a different mental state is required when the charge is aiding and abetting. *See* pp. 22-30, *infra*.

In the law of fraud, reckless disregard for the truth has always been deemed a variety of intent to mislead. *See* pp. 22-30, *infra*. With respect to securities fraud, in particular, deception of investors is a foreseeable consequence of reckless conduct. A publicly traded corporation's insiders, its underwriters, lawyers and accountants, all act with scienter when, in reckless disregard for the truth and the rights of investors, they render substantial assistance to a securities fraud in violation of § 10(b).

III. ARGUMENT

A. Aiding And Abetting Securities Fraud Is A Violation Of Section 10(b) And Rule 10b-5

Aiding and abetting a securities fraud consists of knowingly rendering substantial assistance or encouragement to the perpetration of that fraud.[1] Section 10(b)'s

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[1] *See Reves v. Ernst & Young*, 113 S. Ct. 1163, 1170 (1993) (" 'aid and abet' 'comprehends all assistance rendered by words, acts, encouragement, support or presence' ") (quoting *Black's Law Dictionary* 68 (6th ed. 1990)); *Restatement (Second) of Torts* § 876(b) (1979) ("one is subject to liability if he . . . knows that the other's conduct is a breach of duty and gives substantial assistance or encouragement to the other to so conduct himself"); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970). The "elements" of liability have been variously stated in the case law, but "can be merged or articulated somewhat differently without affecting their basic thrust." *Halberstam v. Welch*, 705 F.2d 472, 478 n.8 (D.C. Cir. 1983).

language is broad enough to encompass liability for aiding and abetting.[2]

Going far beyond imposing liability for individual misrepresentations or omissions, § 10(b) and Rule 10b-5 prohibit *any* deceptive practice or course of conduct that operates to mislead investors in connection with the purchase or sale of securities.[3] To knowingly participate in such a fraudulent practice or course of conduct, whether "directly or indirectly," 15 U.S.C. § 78j, is a violation of the section and Rule.[4]

To knowingly render substantial assistance to a fraudulent course of conduct is, in essence, to participate in it. Thus, in *Nye & Nissen v. United States*, 336 U.S. 613, 618-20 (1949), this Court held that one who aids and abets fraud is himself guilty *as a principal of that fraud*. *Id.* The rule makes sense. A scheme to defraud typically involves multiple parties who conspire with, or aid and abet, one another in order to perpetrate the fraudulent scheme. "[A]ll members" of such a scheme "are responsible."[5]

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[2] The statute makes it unlawful "directly or indirectly" to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Rule 10b-5, in turn, makes it unlawful for any person "directly or indirectly" to employ "any device, scheme, or artifice to defraud," 17 C.F.R. § 240.10b-5(a), to make any misleading statements, 17 C.F.R. § 240.10b-5(b), or to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(c).

[3] *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-53 (1972); *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991); *In re Union Carbide Corp. Consumer Products Business Sec. Litig.*, 676 F. Supp. 458, 466-69 (S.D.N.Y. 1987).

[4] *In re Union Carbide*, 676 F. Supp. at 466-69; *see In re Rospatch Sec. Litig.*, 760 F. Supp. 1239, 1249, 1251-52 (W.D. Mich. 1991).

[5] *Pinkerton v. United States*, 328 U.S. 640, 647 (1946) (mail fraud); *accord Herpich v. Wilder*, 430 F.2d 818, 819 (5th Cir. 1970) (securities fraud), *cert. denied*, 401 U.S. 947 (1971); *Rooney Pace, Inc. v. Reid*, 605 F. Supp. 158, 160-61 & n.5 (S.D.N.Y. 1985) (securities fraud).

> "One or more persons can originate and carry out a scheme to defraud and any number of persons can operate the plan, each doing his part after the machinery is put in motion; and it would be of no consequence that each and all did not actively participate in the several acts . . . if each were aiding and advising in furtherance of the scheme."[6]

Petitioner urges this Court to ignore § 10(b)'s broad proscription of deceptive practices and to depart from general principles of law, understood by the Congress that enacted § 10(b), in order to abolish the liability of aiders and abettors. When Congress enacted § 10(b), American decisions had long recognized "the general principle of the law is that all procurers and abettors of statutory offenses are punishable under the statute, although not expressly referred to in the statute."[7] This rule applied in civil litigation[8] as well as in criminal

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[6] *United States v. Melton*, 689 F.2d 679, 684 (7th Cir. 1982) (mail fraud) (quoting *Reuben v. United States*, 86 F.2d 464, 469 (7th Cir. 1936), *cert. denied*, 300 U.S. 671 (1937)).

[7] *United States v. Bayer*, 24 Fed. Cas. 1046, 1047 (C.C.D. Minn. 1876) (No. 14,547). The leading American treatise on statutory offenses explained that "all persons present giving aid and comfort to another committing an offense, even a felony, are regarded as principals; that is, in legal contemplation doing the deed." Joel Prentiss Bishop, *Commentaries on the Law of Statutory Crimes* § 135, at 142 (3d ed. 1901). "Therefore, if a statute makes the doing of a thing criminal, it includes, with the actual doer, persons who are present lending their countenance and aid." *Id.*

[8] *See, e.g., Toledo A.A. & N.M.R. Co. v. Pennsylvania Co.*, 54 F. 730, 736-37 (C.C.N.D. Ohio) (invoking the rule, in civil litigation, that aiders and abettors of violation of § 10 of the Interstate Commerce Act are liable as principals), *appeal dismissed sub nom. Ex Parte Lennon*, 150 U.S. 393 (1893).

proceedings,[9] and became a part of the general tort law which imposed liability on aiders and abettors.[10]

Congress codified the rule in 1909, abolishing any lingering common law limitations on its application:[11]

> Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces or procures its commission, is a principal.

Act of March 4, 1909, ch. 321, § 332, 35 Stat. 1152 (1909).

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[9] *See, e.g., United States v. Snyder*, 14 F. 554, 555-56 (C.C.D. Minn. 1882) (applying "the rule that all . . . abettors of statutory offenses are punishable under the statutes"); *United States v. Stevens*, 44 F. 132, 139-40 (C.C.D. Minn. 1890); *United States v. Harbison* 26 F. Cas. 130, 130-31 (C.C.E.D. Tenn. 1871) (No. 15,300).

[10] *See, e.g., Virtue v. Creamery Package Mfg. Co.*, 123 Minn. 17, 40, 142 N.W. 930, 939 (1913) ("all who actively participate in any manner in the commission of a tort, or who procure, command, direct, advise, encourage, aid, or abet its commission . . . are jointly and severally liable therefore"); *Cross v. Sylvia Silk Co.*, 222 A.D. 134, 135-36, 225 N.Y.S. 552, 554 (1927).

[11] *See Standefer v. United States*, 447 U.S. 10, 18-19 (1980); *United States v. Martin*, 176 F. 110, 113-14 (D. Iowa 1910). Although common law had long held that aiders and abettors could be punished as principal offenders some decisions – particularly those of English courts – had imposed certain exceptions and procedural qualifications when the rule was applied to felonies. *See Standefer*, 447 U.S. at 15-18; *United States v. Martin*, 176 F. at 112. The distinction between misdemeanor and felony had far less significance in American law where it was abolished by statute, limited judicially, or simply ignored. *See, e.g., Rosencranz v. United States*, 155 F. 38, 43 (9th Cir. 1907); *People v. Newberry*, 20 Cal. 439, 441 (1862); *State v. Poynier*, 36 La. Ann. 572, 574 (1884); *Commonwealth v. Ray*, 69 Mass. (3 Gray) 441, 448 (1855); *McGowan v. State*, 17 Tenn. (9 Yerger) 184, 194 (1836).

Now codified as amended at 18 U.S.C. § 2(a),[12] the rule applies in civil litigation[13] as well as in criminal proceedings.[14]

With this enactment Congress provided that aiding and abetting the violation of *any* federal criminal statute shall itself constitute a principal violation of that statute. Congress " 'abolishe[d] the distinction between principals and accessories and [made] them all principals.' "[15]

When Congress enacted § 10(b) it understood that such a statute, making securities fraud illegal, would also make aiding and abetting securities fraud illegal. Federal courts and the SEC properly found no difficulty in holding that aiding and abetting a violation of the federal securities laws is itself a violation of those laws. *See, e.g., SEC v. Scott Taylor & Co.*, 183 F. Supp. 904, 909 n.12 (S.D.N.Y. 1959); *SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939), *appeal dismissed*, 118 F.2d 718 (9th Cir.

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[12] Although the language of 18 U.S.C. § 2(a) has been modified slightly over the years, there is " 'no evidence of any Congressional intent to change the substantive law that an aider and abettor *is a principal.*' " *United States v. Oates*, 560 F.2d 45, 55 (2d Cir. 1977) (quoting *Swanne Soon Young Pang v. United States*, 209 F.2d 245, 246 (9th Cir. 1953)); *see Standefer*, 447 U.S. at 20. "In other words, one who aids and abets the commission of a crime is not only *punishable* as a principal but *is* a principal." *United States v. Oates*, 560 F.2d at 54.

[13] *E.g., Berlin Communications, Inc. v. FCC*, 626 F.2d 869, 874 & n.13 (D.C. Cir. 1979) (broadcasting license revocation based on application of 18 U.S.C. § 2). The modern tort law's recognition of aider and abettor liability is reflected in § 876(b) of the *Restatement (Second) of Torts*.

[14] *See, e.g., United States v. Blitz*, 533 F.2d 1329, 1341 (2d Cir.) (applying 18 U.S.C. § 2 to violations of § 10(b)), *cert. denied*, 429 U.S. 819 (1976).

[15] *Standefer*, 447 U.S. at 19 (quoting *Hammer v. United States*, 271 U.S. 620, 628 (1926)); *see United States v. Pino-Perez*, 870 F.2d 1230, 1233 (7th Cir.) (*en banc*), *cert. denied*, 493 U.S. 901 (1989); *United States v. Oates*, 560 F.2d at 55.

1941); *Matter of Burley & Co.*, 23 S.E.C. 461, 468 n.11 (1946) (Exchange Act Release No. 3838).

Since those early cases, the circuit courts have uniformly concluded that aiding and abetting securities fraud is a violation of § 10(b) and Rule 10b-5. "Under § 10(b) and Rule 10b-5 knowing assistance of or participation in a fraudulent scheme gives rise to liability equal to that of the perpetrators themselves." *Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731, 740 (10th Cir. 1974). "Aiding and abetting is itself a violation of section 10(b) and Rule 10b-5." *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652 (9th Cir. 1988), *cert. denied*, 493 U.S. 1002 (1989).[16] Federal courts have similarly recognized that aiding and abetting violations of §§ 9 and 18 of the Exchange Act are actionable,[17] and they have accepted the SEC's authority to bring enforcement actions against aiders and abettors of many securities law violations.[18]

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[16] *Accord, e.g., Gross v. SEC*, 418 F.2d 103, 107 (2d Cir. 1969); *Winkler v. SEC*, 377 F.2d 517, 518 (2d Cir. 1967); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 112 S. Ct. 576 (1991); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *SEC v. Washington County Utility District*, 676 F.2d 218, 224 (6th Cir. 1982); *SEC v. First Securities Co.*, 463 F.2d 981, 987 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972); *Carroll v. First National Bank*, 413 F.2d 353, 357 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970); *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 & 1072 (1986); *Little v. Valley National Bank*, 650 F.2d 218, 222-23 (9th Cir. 1981); *Woods v. Barnett Bank*, 765 F.2d 1004, 1009 (11th Cir. 1985); *Batten & Co. v. SEC*, 345 F.2d 82, 83-84 (D.C. Cir. 1964).

[17] *See, e.g., SEC v. Militano*, 773 F. Supp. 589, 591 & 594-95 (S.D.N.Y. 1991) (§ 9); *In re Caesar's Palace Sec. Litig.*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (§ 18); *Sennott v. Rothbart*, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,851 (N.D. Ill. 1970) (§ 9), *rev'd on other grounds sub nom. Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39 (7th Cir.), *cert. denied*, 414 U.S. 926 (1973).

[18] *See, e.g., SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72-73, (D.C. Cir.) (§ 13(a)), *cert. denied*, 449 U.S. 1012; *SEC v. Coven*, 581 F.2d 1020 (2d Cir. 1978) (§ 17(a)), *cert. denied*, 440 U.S. 950 (1979); *SEC v. Universal Major Industries, Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976) (§ 5), *cert. denied*, 434 U.S. 834 (1977); *Wellman v. Dickenson*, 475 F. Supp. 783, 831-32 (S.D.N.Y. 1979) (§ 14), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

This aiding and abetting liability, which is both mandated by Congress through 18 U.S.C. § 2(a) and recognized in decisional law, *does not* create a new, separate or distinct offense.[19] The rule that aiders and abettors are liable as principals *"only serves as a more particularized way of identifying the 'persons involved' in the commission of the substantive offense,* and serves to describe *how* those 'person[s] involved,' committed the substantive offense."[20] Thus, the question presented is not whether this Court should create a new liability under § 10(b) but whether it should, without congressional action, overrule settled precedent in order to *eliminate* a well grounded and long recognized theory of liability.

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[19] *Ruthenberg v. United States*, 245 U.S. 480, 481, 483 (1918) (one defendant's refusal to register for the draft, and other defendants' aiding and abetting that refusal, amount to "but one offense," the aiders and abettors "being charged as principals in procuring [the] refusal"); *see Hammer*, 271 U.S. at 628; *United States v. Erb*, 543 F.2d 438, 446 (2d Cir.) ("[Appellant's] premise is that aiding and abetting is a crime separate from the substantive offense abetted. This is not so."), *cert. denied*, 429 U.S. 981 (1976); *United States v. Pearson*, 667 F.2d 12, 13-14 (5th Cir. 1982) (en banc); *United States v. Moya-Gomez*, 860 F.2d 706, 756 (7th Cir. 1988), *cert. denied*, 492 U.S. 908 (1989); *United States v. Thirion*, 813 F.2d 146, 151 (8th Cir. 1987); *United States v. Stitzer*, 785 F.2d 1506, 1519 n.7 (11th Cir.), *cert. denied*, 479 U.S. 823 (1986); *United States v. Kegler*, 724 F.2d 190, 200-01 (D.C. Cir. 1983); *United States v. J.R. Watkins Co.*, 127 F. Supp. 97, 101 (D. Minn. 1954).

[20] *United States v. Oates*, 560 F.2d at 54 (emphasis added) (quoting *United States v. Campbell*, 426 F.2d 547, 553 (2d Cir. 1970)). "[T]he aiding and abetting statute, 18 U.S.C. § 2, provides a means of establishing liability but does not itself define a crime." *Baumann v. United States*, 692 F.2d 565, 571 (9th Cir. 1982) (citation omitted); *see supra*, note 19.

B. Since Its Inception The Implied Cause Of Action Under Section 10(b) Has Encompassed "Secondary Liability"

Since the 1940s federal courts have recognized an implied private right of action for violations of § 10(b). *See, e.g., Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). These initial decisions recognized damage claims based on allegations of *aiding and abetting* violation of § 10(b) and *conspiracy* to violate § 10(b).[21]

Once an implied cause of action is created under a federal statute, such "secondary" liability principles *necessarily* apply in litigation based on the implied cause of action. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), this Court held that "[h]aving concluded that exchanges can be held accountable" in private actions implied under the Commodity Exchange Act, "*it necessarily follows* that those persons who are participants in a conspiracy to manipulate the market in violation of those rules are also subject to suit by futures traders who can prove injury from these violations." *Id.* at 394 (emphasis added). The Court did not distinguish between implied liability for direct violations of the act and implied liability for conspiring to violate the act. For the same reasons, the Court should not now create a distinction between liability for direct violations of § 10(b) and liability for aiding and abetting such violations.

If conspiracy or aiding and abetting can fairly be characterized as "secondary" liability, they nevertheless are well engrained in our law and have always been a part of the private cause of action under § 10(b). "The

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[21] *See Fry*, 83 F. Supp. at 476; *Kardon*, 69 F. Supp. at 512; *see also Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 675-82 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970); *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963).

right of action was first recognized in *Kardon v. National Gypsum Co.*," when Judge William H. Kirkpatrick of the United States District Court for the Eastern District of Pennsylvania held that allegations of *conspiracy* to defraud stated a violation of the statute that gave rise to a private cause of action for damages.[22] The following month *Fry* held that stock brokers who *aided and abetted* a scheme to defraud could be held liable in a private suit under § 10(b):

> No matter how innocent the brokers' solicitation letter may have appeared and *without regard to whether it contained any fraudulent or misleading statement of fact, if the brokers know, as averred, that it was part of a scheme to defraud an action would lie against them.* In fact, it would be sufficient if they had merely mailed a letter without knowing its contents or even had merely supplied their stationery, *provided they knew that in so doing they were rendering service essential to or participating in a scheme of fraud.*

Fry, 83 F. Supp. at 478 (emphasis added).

The court acknowledged that the complaint "[did] not charge (and appears rather carefully to avoid charging) that the brokers knew of any of the details of the scheme of fraud alleged to have been put into operation by the other defendants or knew of the fraudulent statements alleged to have been made by them." *Id.* It was enough, however, that the brokers had knowingly assisted the fraudulent scheme:

> [I]t seems too plain for argument that a defendant cannot escape liability in an action for

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[22] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1983); *see Kardon*, 69 F. Supp. at 514-15. The leading advocate of weakening securities law enforcement by eliminating secondary liability admits "the case in which an implied private right of action under section 10(b) was first recognized, *Kardon v. National Gypsum Co.*, involved a cause of action alleging conspiracy." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. 80, 85 (1981).

> fraud merely by showing that he was ignorant of the steps by which a fraudulent scheme was to be carried out if it appears that he knew that what he did was a part of it. The averment here, that the brokers sent a solicitation letter knowing that in so doing they were participating in a scheme to defraud, sufficiently states a cause of action at common law against them.

Id. Because the defendant brokers could be held liable under common law principles as "conspirators or joint tortfeasors," the court held, "it follows that the [complaint] states a cause of action against them for violations of the Statute and regulations which are, if anything broader than the common law." *Id.*

Thus, the first two opinions recognizing an implied right of action under § 10(b), *Kardon* and *Fry*, established an implied right of action that encompassed conspiracy and aiding and abetting concepts from the very beginning. Since then, federal courts have reaffirmed, time and again, that aiding and abetting securities fraud gives rise to a private cause of action.[23] It is far too late in the day to change the law on this point without congressional concurrence as this Court, and Congress, have both long approved of or acquiesced in the private cause of action implied in *Kardon* and *Fry*.[24]

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[23] *See, e.g., Brennan*, 259 F. Supp. at 675-82; *Pettit*, 217 F. Supp. at 28; *see also Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44-48 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Monsen*, 579 F.2d at 799-801; *Moore v. Fenex, Inc.*, 809 F.2d 297, 305 (6th Cir.), *cert. denied*, 483 U.S. 1006 (1987); *FDIC v. First Interstate Bank*, 885 F.2d 423, 424, 432 (8th Cir. 1989); *Little*, 650 F.2d at 223; *Zabriskie v. Lewis*, 507 F.2d 546, 553 (10th Cir. 1974); *Kerbs*, 502 F.2d at 740; *Woods*, 765 F.2d at 1009.

[24] "Such claims are of judicial creation, having been implied . . . for nearly half a century. . . . [T]his Court repeatedly has recognized the validity of such claims . . . . " *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2779-80 (1991) (citing

In *Merrill Lynch* this Court held that "the fact a comprehensive reexamination and significant amendment of the [Commodities Exchange Act] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy." *Merrill Lynch*, 456 U.S. at 65-66. When Congress revised the securities laws in 1975, it preserved the implied right of action under § 10(b) against aiders and abettors of securities fraud. In *Herman & MacLean v. Huddleston*, this Court observed that in light of the "well established judicial interpretation" of the § 10(b) cause of action, "Congress' decision to leave § 10(b) intact" when it comprehensively revised the securities laws in 1975 "suggests that Congress ratified the cumulative nature of the § 10(b) action." 459 U.S. at 385-86. "Congress' decision to leave § 10(b) intact," *id.*, in 1975 also suggests that it ratified the private right of action including its conspiracy and aiding and abetting principles. *See id.*

Since 1975 Congress has twice acted to *preserve* the implied cause of action under § 10(b) which, from the very beginning, encompassed "secondary liability" principles.[25] The existence of the implied right of action *and*

Kardon); *see also Herman & MacLean v. Huddleston*, 459 U.S. at 380 n.10 (citing *Kardon*); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (citing *Kardon*). "Judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements." *Basic Inc. v. Levinson*, 485 U.S. 224, 230-231 (1988) (citations omitted). "The existence of this implied remedy is simply beyond peradventure." *Herman & McLean v. Huddleston*, 459 U.S. at 380.

[25] In 1988, when it enacted § 20A of the Exchange Act, Congress expressly provided that "[n]othing in this section shall be construed to limit or condition . . . the availability of any cause of action implied from a provision of this chapter." 15 U.S.C. § 78t-1(d). Even more recently, Congress expressly provided for reinstatement

the federal courts' "cumulative work in its design" were "obvious legislative considerations" in these two recent statutes that "treat[] the 10b-5 action as an accepted feature of our securities laws." *Musick, Peeler & Garrett v. Employers Insurance of Wausau*, 113 S. Ct. 2085, 2089 (1993) (emphasis added).

This Court should not overturn half a century of precedent ratified by Congress – particularly where doing so would conflict with the underlying policy of the securities laws. The aim of Congress in passing the Exchange Act was in large part "to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions." *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986). Liability of aiders and abettors of fraud is crucial to the effective operation of our securities laws.[26] As the Second Circuit pointed out in *United States v. Benjamin*, 328 F.2d

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of implied private civil actions under § 10(b) that otherwise would have been barred by this Court's holding in *Lampf*. *See* 15 U.S.C. § 78aa-1.

[26] Discussing liability of aiders and abetters under § 5 of the Securities Act, the Second Circuit explained:

> In order to accomplish the broad remedial purposes of the Securities Acts, there are compelling reasons to impose [aiding and abetting] liability in Section 5 [15 U.S.C. § 77e] actions. By its terms, Section 5 makes it unlawful, "directly or indirectly" to sell unregistered stock. *The heart of the prohibition would be cut away if the only person covered by its provisions was the individual who actually consummated the sale.* We do not believe the Supreme Court [in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)] intended that those who play an indispensable role in the sale, as appellant did here, should not be subject to SEC initiated, injunctive restraint.

SEC v. Universal Major Industries, 546 F.2d at 1046 (emphasis added; citation omitted).

854, 863 (2d Cir.) (Friendly, J.), *cert. denied*, 377 U.S. 953 (1964):

> In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.

Id.

An aider and abettor of a § 10(b) violation who may be held accountable in an SEC enforcement action or criminal prosecution must also be held accountable to the victims of the fraud. This Court has *rejected* the notion that § 10(b) means one thing for SEC actions and something very different for everyone else. *Aaron v. SEC*, 446 U.S. 680, 691 (1980). Moreover, "[i]mplied private actions provide 'a most effective weapon in the enforcement' of the securities laws and 'are a necessary supplement to Commission action.' "[27] Rendering aiders and abettors of securities fraud immune to such suits would seriously undermine the deterrence and disclosure goals of the Exchange Act.

Compensating defrauded investors is another essential purpose of the Exchange Act, *see Randall*, 478 U.S. at 647, that would suffer if aider and abettor liability were abolished. The cause of the investors' injuries seldom is the conduct of a single principal violator:

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[27] *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)). The implied private right of action under § 10(b) "constitutes an essential tool for enforcement of the 1934 Act's requirements." *Basic Inc.*, 485 U.S. at 231 (citation omitted).

> It is now well settled that accountants who aid and abet others in violating the anti-fraud provisions of the securities laws may be held jointly liable with such persons in private actions for damages. . . . *To deny . . . investors, who were injured by this combined fraudulent conduct, a cause of action against all of the wrongdoers would leave the plaintiffs with half a remedy* and would run afoul of the Supreme Court's repeated admonition that the securities laws are to be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes."

Bolger v. Laventhol, Krekstein, Horwath & Horwath, 381 F. Supp. 260, 268 (S.D.N.Y. 1974) (emphasis added) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

The language and purpose of § 10(b), general principles of law, and nearly half a century of precedent *repeatedly ratified by Congress* all mandate continued recognition of aider and abettor liability under § 10(b).

C. There Is No Reason To Exclude Aiding And Abetting Violations Of Section 10(b) From The Violations That Give Rise To An Implied Cause Of Action

To avoid application of the general rule that aiding and abetting violation of a statute is itself a violation requires " ' "an affirmative legislative policy" to create an exemption from the ordinary rules of accessorial liability.' "[28] Petitioner contends that Congress implicitly rejected

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[28] *Pino-Perez*, 870 F.2d at 1234 (citations omitted). The burden is *on petitioner* to show that in enacting § 10(b) Congress intended a special exemption from the usual rules of liability for aiders and abettors. *See Pino-Perez*, 870 F.2d at 1233. Shifting the burden to the respondent to demonstrate a special Congressional intent *to impose* aider and abettor liability "would essentially abolish federal aider and abettor liability." *Id.* at 1234.

liability of aiders and abettors when it provided for "controlling person" liability in § 20(a) of the Exchange Act, and that subsequent legislative action (or inaction) eliminated any private cause of action for aiding and abetting. These arguments lack merit.

1. Congress' Extension of Liability To Controlling Persons Raises No Inference That It Intended To Eliminate More Traditional Theories Of Liability

No inference against traditional theories of secondary liability can be drawn from Congress' express provision for "controlling person" liability in the Exchange Act.

Congress knew that it did not have to say anything about aiding and abetting or conspiracy for § 10(b) to reach such conduct.[29] Applying traditional principles of law any participant, including those who knowingly assisted the wrong – would be liable.[30] Principals would be liable for acts of their agents, and employers for the wrongs of their employees committed in the course of employment.[31] *But the traditional principles did not reach far enough for Congress.*

Conspiracy and aiding and abetting principles require a prima facie showing of *some wrongful conduct* by the defendant – either an agreement to do wrong (conspiracy) or culpable assistance of the wrong (aiding and abetting). Respondeat superior liability reaches corporate

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[29] *See Pino-Perez*, 870 F.2d at 1233. No inference against "secondary" liability can be drawn from the fact that Congress did not identify "aiding and abetting" or "conspiracy" by name when it outlawed fraudulent practices with § 10(b) – for to identify these theories of liability by name would have been the merest surplusage. *See id.* at 1234.

[30] *See Merrill Lynch*, 456 U.S. at 394; *Nye*, 336 U.S. at 618-20; *Restatement (Second) of Torts* § 876(b).

[31] *See Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 (9th Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 1621 (1991).

employers, but it does not reach corporate officers or others who may in fact control the actions of a company and its employees. For this reason Congress enacted § 20(a) of the Exchange Act which extends liability to controlling persons. 15 U.S.C. § 78t(a). To establish prima facie liability a plaintiff need not show a controlling person was a "culpable participant" in the wrongful conduct.[32]

By thus *extending* liability beyond the traditional boundaries of aiding and abetting, conspiracy, and respondeat superior principles, "§ 20(a) was intended to supplement, and not to supplant" the traditional theories of liability.[33] "[T]here is no warrant for believing that Section 20(a) was intended to narrow the remedies" available to victims of fraud, "or to create a novel defense in cases otherwise governed by traditional agency principles." *Marbury Management*, 629 F.2d at 716; *accord Hollinger*, 914 F.2d at 1577. The section's legislative "history does not reflect any congressional intent to restrict secondary liability for violations."[34]

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[32] *See First Interstate Bank v. Pring*, 969 F.2d 891, 897-98 (10th Cir. 1992), *cert. granted*, 113 S.Ct. 2927 (1993); *Hollinger*, 914 F.2d at 1574-75; *Metge*, 762 F.2d at 632; *see also Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir. 1980), *cert. denied*, 449 U.S. 1011 (1980); *Richardson v. MacArthur*, 451 F.2d 35, 41-42 (10th Cir. 1971).

[33] *Hollinger*, 914 F.2d at 1576; *accord, e.g., In re Atlantic Financial Management, Inc.*, 784 F.2d 29, 32-34 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987); *Marbury Management*, 629 F.2d at 712-16; *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Fey v. Walston & Co.*, 493 F.2d 1036, 1052 (7th Cir. 1974); *Commerford v. Olson*, 794 F.2d 1319, 1322-23 (8th Cir. 1986); *Kerbs*, 502 F.2d at 731, 740-41; *see* David S. Ruder, *Multiple Defendants In Securities Law Fraud Cases: Aiding and Abetting, Conspiracy,* In Pari Delicto, *Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597, 605-07 (1972).

[34] *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980); *see* William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws – Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common Law Principles and Statutory Scheme*, 14 J. Corp. L. 313, 351-54 (1988); Ruder, *supra* note 33, at 605-07.

For this Court to hold that – instead of *extending* liability to controlling persons – § 20(a) *eliminates liability of culpable participants* in fraudulent conduct, would be to give the section quite the opposite of its intended meaning and effect.[35]

2. Subsequent Legislative Action And Inaction Did Not Destroy Aider And Abetter Liability Under Section 10(b)

Petitioner suggests that legislative action (and inaction) since 1934 has had the effect of abolishing liability of aiders and abettors under § 10(b). Petitioner is wrong.

Petitioner contends that aiding and abetting liability under § 10(b) was rejected by Congress in 1959 when it declined to enact a proposed amendment to the securities acts that would have expressly imposed liability on aiders and abettors. However, such "Congressional inaction lacks 'persuasive significance' because 'several equally tenable inferences' may be drawn from such inaction, 'including the inference that the existing legislation already incorporated the offered change.' "[36]

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[35] In *Herman & MacLean v. Huddleston*, this Court rejected arguments that Congress' provision for special liabilities and defenses under § 11 of the Securities Act could exempt conduct subject to § 11 from liability under § 10(b): "It would be anomalous indeed if the special protection afforded to purchasers in a registered offering by the 1933 Act were deemed to deprive such purchasers of the protections against manipulation and deception that § 10(b) makes available to all persons who deal in securities." 459 U.S. at 383. It would be *even more anomalous* to hold that a provision intended to *extend* the scope of liability under § 10(b) should instead operate to contract it and to immunize conspirators and aiders and abettors of fraud from liability for their wrongs.

[36] *Pension Benefit Guaranty Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990) (quoting *United States v. Wise*, 370 U.S. 405, 411 (1962)).

In fact, the legislative history shows that the amendment was rejected as unnecessary because aiders and abettors were already liable under existing law.[37]

Petitioner also contends that a subsequent amendment to § 15, to clarify the SEC's enforcement authority over brokers and dealers, had the effect – by implication – of eliminating all other liability of aiders and abettors. If Petitioner is correct it is difficult to explain how the SEC has continued to pursue so many enforcement actions *beyond* those authorized by § 15 against aiders and abettors of various securities violations.[38] Moreover, petitioner's argument "would surely do violence to the ' "cardinal rule . . . that repeals by implication are not favored." ' " *TVA v. Hill*, 437 U.S. 153, 189 (1978) (citations omitted). "In practical terms, this 'cardinal rule' means

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[37] *See* S. Rep. No. 1757, 86th Cong., 2d Sess. 8-9 (1960). The amendment was understood by the SEC to be only a "clarification" of the existing law designed to "make it clear that an indirect violation of the act is unlawful." *Hearings on S. 1178-1182 Before A Subcommittee of the Senate Committee on Banking and Currency*, 86th Cong., 1st Sess. 275-76 (1959). "[A]t that time the *Timetrust*, *Scott Taylor*, and *Fry* cases had all been decided," *Brennan*, 259 F. Supp. at 678, and the SEC had *for decades* exercised enforcement authority over aiding and abetting violations of § 10(b). *See Matter of Burley & Co.*, 23 S.E.C. at 468 n.11 (1946). Under such circumstances Petitioner cannot "successfully contend that the failure to pass the clarifying amendment shows a Congressional intent that [§ 10(b)] has no applicability to aiders and abettors." *Brennan*, 259 F. Supp. at 678.

[38] The SEC has continued to prosecute aiding and abetting violations of § 10(b) and Rule 10b-5 in its civil enforcement actions, and federal courts have uniformly accepted its authority to do so. *See, e.g., SEC v. Washington County Utility District*, 676 F.2d at 224; *SEC v. Spectrum, Ltd.* 489 F.2d 535, 542 (2d Cir. 1973); *Winkler*, 377 F.2d at 518; *SEC v. Kimmes*, 799 F. Supp. 852, 859 (N.D. Ill. 1992); *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 648 (D.D.C. 1975). The SEC also has continued to prosecute aiding and abetting violations of other provisions of the securities laws, *without* the express statutory authorization petitioner contends is necessary to create liability under § 10(b). *See supra* notes 18, 26.

that '[i]n the absence of some affirmative showing of an intention to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable.' " *TVA*, 437 U.S. at 190 (citation omitted).

No affirmative intention to repeal aider and abettor liability can be shown and any suggestion that liability for aiding and abetting is somehow "irreconcilable" with SEC enforcement authority is simply ludicrous. The "positive repugnancy" required for a repeal by implication is altogether missing. *TVA*, 437 U.S. at 190. Congress did not, by clarifying SEC enforcement authority over brokers and dealers in § 15, intend to abrogate liability of aiders and abettors more generally.

D. Recklessness Satisfies The Scienter Element Of Aider And Abettor Liability

Aiding and abetting the violation of a statute necessarily entails an element of willful or purposive behavior. "In order to aid and abet another to commit a crime it is necessary that a defendant 'in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed.' " *Nye & Nissen*, 336 U.S. at 619 (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938)). However, because "[a]iding and abetting is not a separate crime but rather is linked to the underlying offense," it also "shares the requisite intent of that offense,"[39] and even in criminal cases, recklessness can suffice to establish liability for aiding and abetting a

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[39] *United States v. Roan Eagle*, 867 F.2d 436, 445 (8th Cir.) (rejecting arguments that aiding and abetting murder necessarily requires a showing of specific intent), *cert. denied*, 490 U.S. 1028 (1989); *see United States v. Holland*, 831 F.2d 717, 719-20 (7th Cir. 1987); *United States v. Beck*, 615 F.2d 441, 450-51 (7th Cir. 1980); *United States v. Burkhalter*, 583 F.2d 389, 391-92 (8th Cir. 1978).

statutory offense.[40] Because aiding and abetting securities fraud is a deceptive practice that violates § 10(b), *see supra* at 1-17, it would be illogical to require a greater showing of scienter than the recklessness which generally satisfies the knowledge or intent requirement of § 10(b).

A serious difficulty with a higher scienter standard for aiding and abetting is the lack of any clear distinction between primary violations and aiding and abetting. If an accountant actively assists in a company's unlawful sale of securities, is he a primary violator or an aider and abettor? If different standards of scienter are applied to aiders and abettors, this collateral issue will be fought in each case, with artificial distinctions proposed and debated. Similarly, if different scienter standards apply depending upon whether those who assist the execution of fraud possessed a pre-existing "duty" to speak or act, courts will be embroiled in needless debates to define the existence and scope of such duties.

There is no reason to embroil the courts in such debates. *Everyone* possesses a duty not to perpetrate, or to assist in the perpetration of, securities fraud. One who makes a statement with a conscious indifference to its truth or falsity, or who aids and abets another with a reckless disregard to whether investors are misled and defrauded, acts in a knowingly deceptive fashion and should not escape liability for his or her dishonest conduct – whether or not he (or she) has breached some other duty as well.

1. Reckless Conduct Establishes Intent To Defraud

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court observed that "[i]n certain areas of the law

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[40] *See, e.g., United States v. Hughes*, 891 F.2d 597, 601 (6th Cir. 1989) (reckless disregard sufficient to sustain conviction for aiding and abetting misapplication of federally insured bank funds); *United States v. Sarantos*, 455 F.2d 877, 880-82 (2d Cir. 1972) (sustaining attorney's conviction for recklessly aiding and abetting false representations to INS). *See* John P. Freeman & Nathan M. Crystal, *Scienter in Professional Liability Cases*, 42 S. C.L. Rev. 783, 839-44 (1991).

recklessness is considered to be a form of intentional conduct." *Hochfelder*, 425 U.S. at 194 n.12; *see Rolf*, 570 F.2d at 45 n.12. *The law of fraud is one of those areas.*

In the criminal law, "[f]raudulent intent is shown if a representation is made with reckless indifference to its truth or falsity." *United States v. Cusino*, 694 F.2d 185, 187 (9th Cir. 1982), *cert. denied*, 461 U.S. 932 (1983) (citation omitted). The circuit courts therefore "have repeatedly held that reckless indifference alone will support a mail fraud conviction,"[41] and recklessness is sufficient to establish criminal intent to defraud under the securities statutes.[42] Recklessness also

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[41] *United States v. Gay*, 967 F.2d 322, 326 (9th Cir.), *cert. denied*, 113 S. Ct. 359 (1992) (citation omitted); *see, e.g., United States v. Amrep Corp.*, 560 F.2d 539, 543-44 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978); *Bentel v. United States*, 13 F.2d 327, 329 (2d Cir.), *cert. denied*, 273 U.S. 713 (1926); *United States v. Boyer*, 694 F.2d 58, 59 (3d Cir. 1982) ("specific intent to deceive could be found from material misstatement of fact made with reckless disregard of the facts"); *United States v. Frick*, 588 F.2d 531, 536 (5th Cir.), *cert. denied*, 441 U.S. 913 (1979); *United States v. Hathaway*, 798 F.2d 902, 909 (6th Cir. 1986); *United States v. Henderson*, 446 F.2d 960, 966 (8th Cir.), *cert. denied*, 404 U.S. 991 (1971); *United States v. Themy*, 624 F.2d 963, 965 (10th Cir. 1980) ("indifference to the truth of statements made to induce others to action amounts to fraudulent intent"); *Irwin v. United States*, 338 F.2d 770, 774 (9th Cir. 1964), *cert. denied*, 381 U.S. 911 & 919 (1965); *United States v. Sawyer*, 799 F.2d 1494, 1502 (11th Cir. 1986), *cert. denied*, 479 U.S. 1069 (1987). The same rule applies in civil RICO actions based on criminal mail fraud. *See, e.g., O'Malley v. New York City Transit Authority*, 896 F.2d 704, 706 (2d Cir. 1990); *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236 (3d Cir. 1989); *Diamonds Plus, Inc. v. Kolber*, 960 F.2d 765, 768 (8th Cir. 1992).

[42] *See, e.g., Boyer*, 694 F.2d at 59-60 (§ 10(b) violation); *United States v. Farris*, 614 F.2d 634, 638 (9th Cir. 1979) (§ 17(a) violation), *cert. denied*, 447 U.S. 926 (1980); *United States v. Weiner*, 578 F.2d 757, 786-87 (9th Cir.) (§§ 6, 17 & 13 violations), *cert. denied*, 439 U.S. 981 (1978); *United States v. Natelli*, 527 F.2d 311, 323 (2d Cir. 1975) (§ 14 violation), *cert. denied*, 425 U.S. 934 (1976). Recklessness also suffices to establish scienter for violations of state law securities regulations

suffices to establish civil liability for fraud. *Equitable Life Ins. Co. v. Halsey, Stuart & Co.*, 312 U.S. 410, 420-21 (1941) (Iowa law).

"At common law reckless behavior was sufficient to support causes of action sounding in fraud or deceit." *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1044 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *see Rolf*, 570 F.2d at 46. The common law decisions are, indeed, virtually unanimous in holding that recklessness satisfies the requirement of fraudulent intent.[43]

"Fraud is proved when it is shown that the false representation was made knowingly, or in conscious ignorance of the truth, or recklessly, without caring whether it be true or false." *Warren Balderston Co. v. Integrity Trust Co.*, 314 Pa. 58, 60, 170 A. 282, 283 (1934). "Fraud includes the pretense of knowledge when knowledge there is none." *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, J.). Thus, "[a]

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patterned after § 10(b). *See, e.g., State v. Hynds*, 84 Wash. 2d 657, 663-64 & nn. 1-2, 529 P.2d 829 (1974).

[43] With the single exception of North Carolina, *every* American state has concluded that recklessness supplies the necessary fraudulent intent for common law fraud. *See* Kevin R. Johnson, *Liability for Reckless Misrepresentations and Omissions Under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. Cin. L. Rev. 667, 700-06 (1991). The rule was firmly established in the English common law. "[I]n an action of deceit the representation to found the action *must not be innocent*, that is to say, it must be made either with knowledge of its being false, *or with a reckless disregard* as to whether it is or is not true." *Arkwright v. Newbold*, 17 Ch.D. 301, 320 (1881) (Cotton, L.J.) (emphasis added). "[F]raud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) *recklessly, careless whether it be true or false.*" *Derry v. Peek*, 14 App. Cas. 337, 374 (H.L. 1889) (Lord Herschell) (emphasis added). If the American common law differs from English law, it is because our law gives an even wider scope to the recklessness that will satisfy the element of fraudulent intent. *See, e.g., Schlechter v. Felton*, 134 Minn. 143, 146-47, 158 N.W. 813, 814-15 (1916); *see also* Freeman & Crystal, *supra* note 40, at 790-91.

representation certified as true to the knowledge of the [defendants] when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability." *State Street Trust Co. v. Ernst*, 278 N.Y. 104, 112, 15 N.E. 2d 416, 418-19 (1938).

This Court's own precedents concur with the common law's recognition that reckless disregard – or the making of statements with no sufficient basis – can satisfy the requirement of intent to mislead. In *Cooper v. Shlesinger*, 111 U.S. 148 (1884), for example, this Court held that "the jury were properly instructed that *a statement recklessly made*, without knowledge of its truth, *was a false statement knowingly made.*" *Id.* at 155 (emphasis added). In *Lehigh Zinc & Iron Co. v. Bamford*, 150 U.S. 665 (1893), this Court held that "a person who makes representations of material facts, assuming or intending to convey the impression that he has actual knowledge of the existence of such facts, when he is conscious that he has no such knowledge, is as much responsible for the injurious consequences of such representations, to one who believes and acts upon them, as if he had actual knowledge of their falsity. . . . "[44]

The thrust of the common law decisions is that a statement recklessly made is one not *honestly* made. "For a man who makes a statement without care and regard

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[44] *Lehigh Zinc*, 150 U.S. at 673. Nearly a century later, in *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2758 (1991), this Court held in a case arising under § 14(a) of the Exchange Act that public representations "in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading." Thus, a statement made with knowledge that it lacks a reasonable basis is a statement made with knowledge of its misleading character – that is, *with intent to mislead* or defraud. *See Lehigh Zinc*, 150 U.S. at 673; *Cooper*, 111 U.S. at 155.

for its truth or falsity commits a fraud. He is a rogue."[45] At common law recklessness is just one form of *intent to mislead*.[46]

> There is of course no difficulty in finding the required *intent to mislead* where it appears that the speaker believes his statement to be false. Likewise, there is general agreement that *it is present when the representation is made without any belief as to its truth, or with reckless disregard* whether it be true or false. Further than this, it appears that all courts have extended it to include representations made by one who is conscious that he has no sufficient basis of information to justify them.[47]

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[45] *Derry*, 14 App. Cas. at 350 (Lord Bramwell); *see also id.* at 374, 376 (Lord Herschell) (statements recklessly made are not made with a completely "honest belief" in their truth and accuracy); *O'Neill Const. Co. v. Philadelphia*, 335 Pa. 359, 364, 6 A.2d 525, 527-28 (1939) (observing that under *S. Pearson & Son, Ltd. v. Dublin Corp.*, [1907] App. Cas. 351, representations made "with a knowledge of their falsity *or with reckless indifference* as to whether they were true or false" cannot qualify as "honest mistakes") (emphasis added).

[46] "[A] representation recklessly made, without knowledge of its truth, cannot be a statement honestly believed, but, on the contrary, is regarded as a false statement knowingly made. . . . [I]n putting his statement in such form as to amount to an assertion that he has knowledge of its truth, [one] is guilty of an intentional falsehood." *Otis & Co. v. Grimes*, 97 Colo. 219, 222, 48 P.2d 788, 789 (1935) (citation omitted); *see also Kriner v. Dinger*, 297 Pa. 576, 582 147 A. 830, 832 (1929).

[47] W. Page Keeton, et al., *Prosser and Keeton on the Law of Torts* § 107, at 741-42 (5th ed. 1984) (emphasis added); *see Rolf*, 570 F.2d at 45 (quoting William Prosser, *Law of Torts* § 107, at 700 (4th ed. 1971)). This has been hornbook law for a long time: "[I]f a man makes a positive representation of fact, believing it to be true, without having any information or any *adequate* information upon which to base it, . . . he then acts, to his own knowledge, falsely." Melville M. Bigelow, *The Law of Fraud* § 3, at 62-63 (1877) (emphasis in original).

A statement recklessly made without regard to its truth or falsity, then, is one made *with a substantial intent to deceive*. A defendant is presumed to intend the natural consequences of his acts, and a natural consequence of statements recklessly made is deception.[48] "[H]e is as culpable as if he had willfully asserted that to be true which he absolutely knew to be false, and is equally guilty of fraud." *Otis & Co.*, 97 Colo. at 222, 48 P.2d at 789. " '[H]is mind is wicked, not because he is negligent, but because he is dishonest in not caring about the truth of his statement.' " *Schlechter*, 134 Minn. at 146, 158 N.W. at 815 (quoting *LeLievre v. Gould*, [1893] 1 Q.B. 491, 498 (Lord Bowen)).

Reckless disregard for the truth accordingly satisfies the requirement of § 10(b) that a defendant act in some sense dishonestly or with intent to defraud. In *Ernst & Ernst v. Hochfelder*, this Court observed that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' " in § 10(b), "strongly suggest that § 10(b) was intended to proscribe *knowing or intentional* misconduct." 425 U.S. at 197 (emphasis added). Reckless conduct *is a form of knowing or intentional conduct* in the law of fraud, *see Cooper*, 111 U.S. at 155; *Rolf*, 570 F.2d at 45, and reckless conduct that foreseeably misleads investors, or that substantially assists the perpetration of fraud, *is dishonest conduct*. Thus it is no surprise that since *Hochfelder* every circuit court to consider the issue has concluded that recklessness can satisfy the scienter element for aiding and abetting a § 10(b) violation.[49]

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[48] *See Claflin v. Commonwealth Ins. Co.*, 110 U.S. 81, 95 (1884); *Buechin v. Ogden Chrysler-Plymouth, Inc.*, 159 Ill. App. 3d 237, 247-48, 511 N.E.2d 1330, 1336 (1987); *Groves v. First National Bank*, 518 N.E.2d 819, 825 (Ind. App. 1988); *Smith v. Chadwick*, 9 App. Cas. 187, 190 (H.L. 1884) (Lord Selbourne).

[49] *See, e.g., Rolf*, 570 F.2d at 44-47; *Monsen*, 579 F.2d at 799; *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 780 (3d Cir. 1976); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992); *Broad v. Rockwell International Corp.*, 642 F.2d 929,

This is no time to change the law. This Court has repeatedly recognized that "an important purpose of the federal securities laws was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Herman & MacLean v. Huddleston*, 459 U.S. at 389. It would "be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive than its common law analogs." *Sundstrand*, 553 F.2d at 1044 (footnote omitted).

2. One Who Is Under No "Duty" To Speak Or To Act Still Is Under A Duty Not To Recklessly Aid And Abet Perpetration Of Fraud

Petitioner contends that liability may not be imposed for recklessly aiding and abetting fraud "where there is no breach of a duty to disclose or to act," but its argument confuses the fundamental issues.

Absent some duty to speak, of course, pure silence or inaction cannot be misleading.[50] Therefore, where a securities fraud action is predicated on a defendant's silence, there is no fraud absent a duty to speak.[51] Absence of a duty to speak or to act, however, does not protect those who choose to speak from liability for fraud. To the contrary, " 'Rule 10b-5 is violated whenever assertions are made . . . in a manner reasonably calculated to influence the investing public . . . if such assertions are false or

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961-62 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981); *Herm v. Stafford*, 663 F.2d at 684; *K & S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 978 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 2993 (1992); *FDIC v. First Interstate Bank*, 885 F.2d at 432-3; *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1483 nn.4-5 (9th Cir. 1991); *Little*, 650 F.2d at 218; *First Interstate Bank*, 969 F.2d at 903; *Woods*, 765 F.2d at 1011.

[50] "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic Inc.*, 485 U.S. at 239 n.17.

[51] *See, e.g., Dirks v. SEC*, 463 U.S. 646, 654 (1983); *Chiarella v. United States*, 445 U.S. 222, 235 (1980).

misleading or are so incomplete as to mislead. . . . ' "[52] This means that one who is under no duty to say anything at all still is under a duty not to mislead investors – a duty to speak the whole truth – *if* he does choose to speak.[53]

The principle applies whether the charge is a "primary" violation or aiding and abetting. Liability for aiding and abetting has always been founded upon the fact that "[a] citizen has no right to aid in breaking the laws of his country, and is bound alike in law and morals to abandon all service for another the moment he has good reason to believe his business is carried on in disregard of them." *Harbison*, 26 F. Cas. at 130.

It is a mistake to think that the duty to refrain from fraud, or from aiding and abetting fraud, must be found in the terms of an indenture of trust or other fiduciary relationship – as the petitioner appears to contend. The duty of a citizen to avoid aiding and abetting fraud applies without regard to petitioner's status as a fiduciary or its obligations as set forth in any trust indenture. *See Aaron*, 446 U.S. at 694-95 (§ 10(b) applies to nonfiduciary transactions as well as to fiduciary transactions).

Of course, the existence and breach of a fiduciary relationship, or other duty to speak or to act, may be relevant *as evidence* that a defendant aided and abetted fraud.[54] Absence of a fiduciary relationship does not entitle

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[52] *Basic Inc.*, 485 U.S. at 235 n.13. (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969)).

[53] *See First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977), *cert. denied*, 439 U.S. 952 (1978); 37 *Am. Jur.* 2d, Fraud & Deceit § 151, at 209 & n.1 (1968).

[54] Breach of such a duty may constitute substantial assistance to a scheme to defraud. It also may support a finding that the defendant acted recklessly. The conduct to be expected of a given defendant always depends upon his or her circumstances and training. Just as a reasonable doctor may be expected to act

anyone to perpetrate – or to aid and abet the perpetration of – a fraud. Conscious indifference to whether one's statements are misleading – or to whether one is rendering substantial assistance to fraud – sufficed to establish liability at common law and it should suffice under § 10(b).

IV. CONCLUSION

For nearly half a century there has been an implied right of action under § 10(b) against aiders and abettors. For more than a century recklessness has been held to be a form of fraudulent intent. This Court should reject the petitioner's request to rewrite the law of securities fraud.

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differently than a reasonable layman, so an accountant or underwriter's conduct may be evaluated in light of his or her training and responsibility. Keeton, et al., *Prosser and Keeton on the Law of Torts* § 32, at 185. The accountant's position of public trust, the underwriter's special knowledge and expertise regarding securities and finance, the corporate officer's unique knowledge of his company and role as representative of stockholders – all may be relevant to whether such a person acted reasonably, unreasonably, *or recklessly* under the circumstances. That does not mean that a special legal standard of negligence or recklessness should be created for every case, or that only fiduciaries can recklessly aid and abet a fraud. *See* Kuehnle, *supra* note 34 at 327-330; Don J. McDermott, Jr., Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damages Actions*, 62 Tex. L. Rev. 1087, 1108-1114 (1984).